

Public Finance

Peking University HSBC Business School

Fall 2013 / 1st Module

EE&FE

Instructor: Dr. Daeyong Lee
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Class meeting: Lectures are given M/Th at 8:30~10:20am

Classroom: C102

Office hours: M/Th 10:30~11:30 am, or by appointment

Teaching Assistant: TBA

1. Course Overview

Public finance (also known as public economics) studies the economics of government taxation and redistribution in market economies, in theory and practice. We will analyze the reason for government interventions in a market economy, as well as the impact of alternative government interventions on economic outcomes. Public economics include two primary topics of analysis: government expenditures and taxation. This course covers both topics, with a focus on the impact of government intervention on the relevant agents: households (consumers, workers) and firms. The class will also briefly present different tax systems in different parts of the world, especially focusing on the U.S. tax system. In this course, you will learn how to interpret economic analyses and how to use the tools of microeconomics and empirical analysis to investigate and predict the effects of public expenditures, regulations and government revenue-raising activities. Although not mandatory, this class will provide you with the necessary background for its companion class taught in the second semester: *"Taxation and Business Strategies."* (Spring 2014)

Prerequisites:

For this class, you are required to have passed "microeconomics" with at least a "C", and "mathematics for economists" with at least a C. Students with background in statistics and/or econometrics will find this class more accessible. Basic knowledge of econometric software such as STATA and SAS is recommended.

2. Coursework and Grading

Midterm: 25%

Final: 40%

Team Project: 30%

Class participation: 5%

• Exams:

There will be a midterm, and a final exam. Both exams will include multiple-choice questions, problems, or short essays. The midterm will be **on Thursday September 26**. The Final will be held on **either November 11 or November 12, depending on the school policy**.

• Team Project:

Students need to make a presentation of their projects at the end of the semester. Each group (3 students) chooses one of the topics that the class covers and applies it to current Chinese systems, especially focusing on Shenzhen and the Guangdong province. Students should analyze the current Chinese system and compare it with the one of the US, and finally suggest a new or better policy to improve the current system. The presentation will be evaluated based on the presentation skill, the level of understanding the topic, how to handle questions during the presentation, and the feasibility of the suggested policy under the current Chinese system. Each group will have 20 minutes for the presentation and 10 minute Q&A time.

• Class participation:

Students will be graded for their “participation” in class, including presence and oral participation.

3. Course Materials

Required Textbook: **Jonathan Gruber, *Public Finance and Public Policy*, 4th ed. Worth Publishers. [JG]** *This book is currently available for consultation in the administration office.*

Recommended references:

Rosen, Harvey and Ted Gayer, *Public Finance*, 9th ed., McGraw-Hill, 2010. **[HR&TG]**

An older version (ed. 2008) of this book is available at the library. Classno: F817.12/1.v8

• Other required and optional readings: A list of journal articles is provided below.

4. Class Schedule (tentative)

Part 1: Introduction to Public Finance (Lecture 1) - JG Ch. 1&2; HR&TG Part I (Ch. 1-3)

• Presentation; Course Overview;

• Introduction to Public Finance and Background

Parts 2: Externalities, Public Goods and Public Choice; Layers of Governments; Social Insurance

- Welfare economics; Market failures: definition, formalization, government role; Externalities: Theory; Private and Public Solutions; Applications: Environmental Damages; (**Lecture 2**) – JG Ch. 5&6; HR&TG Ch. 5
- Market Failures: Public goods; Club Goods; Common Property (**Lecture 3**) - JG Ch. 7; HR&TG Ch. 4
- Cost Benefit Analysis (**Lecture 4**) - JG Ch. 8
- Optimal Fiscal Federalism: State and Local Governments; Decentralization (**Lecture 5**) - JG Ch. 10

References

James Adreoni and Theodore Bergstrom, “Do government subsidies increase the private supply of public goods? ,” *Public Choice*, 1996, 295-308

* James Buchanan, “An economic theory of clubs,” *Economica*, 1965, 1-14.

* H. Scott Gordon, “The economic theory of a common property resource,” *Journal of Political Economy*, April 1954, 124-142.

* Theodore Bergstrom, Lawrence Blume and Hal Varian, “On the private provision of public goods,” *Journal of Public Economics*, 1986, 25-49.

* Tiebout, Charles, “A pure theory of local expenditures,” *Journal of Political Economy*, 1956, 416-24.

* Ronald Coase, “The problem of social cost,” *Journal of Law and Economics*, 1960, 1-44.

* William Vickery, “Pricing in urban and suburban transport,” *American Economic Review*, 1963, 452-65.

Part 3: Social Insurance and Redistribution

- Social Insurance and Social Security (**Lecture 6**) - JG Ch. 12&13
- Health Insurance (**Lecture 7**) - JG Ch. 15&16
- Midterm (**Lecture 8**)

References

Abel, A. B. "Precautionary savings and accidental bequests." *American Economic Review* 75, no. 4 (September 1985): 777-791.

Abel, Andrew B. "The Effects of Investing Social Security Funds, in the Stock market When Fixed Costs Prevent Some Households from Holding Stocks." *American Economic Review* 91, no. 1 (March 2001): 128-48.

Bernheim, D., J. Skinner, and S. Weinberg. "What Accounts for the Variation in Retirement Wealth Among U.S. Households?" *American Economic Review* 91, no. 4 (2001): 832-857.

Brian Knight, "Endogenous Federal grants and crowd-out of State government spending: Theory and evidence from the Federal Highway Aid Program," *American Economic Review*, March 2002, 71-92.

Diamond, P., and J. Geanakoplos. "Social Security Investment in Equities." *American Economic Review*(2003).

Gruber, J., and M. Lettau. "How Elastic is the Firm's Demand for Health Insurance." July 2004, *Journal of Public Economics*.

James R. Hines, Jr. and Richard Thaler, "Anomalies: The flypaper effect," *Journal of Economic Perspectives*, Fall 1995, 217-226

Hurd, M., and S. Rohwedder. "The Retirement-Consumption Puzzle: Anticipated and Actual Declines in Spending at Retirement." *NBER Working Paper* 9586 (March 2003).

Leora Friedberg, "The labor supply effects of the Social Security earnings test," *The Review of Economics and Statistics*, Volume 82 (1), February 2000, 48-63

* Martin Feldstein, "Social Security, induced retirement, and aggregate capital accumulation," *Journal of Political Economy*, Sep. 1974, 905-26.

* Michael Rothschild and Joseph E. Stiglitz, "Equilibrium in competitive insurance markets," *Quarterly Journal of Economics*, 1976, 629-49.

Part 4: Taxation in Theory and Practice

- Introduction to Taxation: Taxation around the World (Types, Structure); Criteria for Evaluating Tax Systems: Fairness, Efficiency, Administrative Burden (**Lecture 9**) - JG Ch. 18
- Tax Incidence: Which side of the market bears the burden of taxes? (**Lecture 10**) - JG Ch. 19
- Optimal Taxation: Taxation and Efficiency; Taxation of Consumption and Income in Theory and Practice (**Lecture 11**) - JG Ch. 20
- Issues with income taxation: Taxing Labor; How Labor Reacts to Taxes in Theory; Empirical Evidence; Labor Incentive Mechanisms (**Lecture 12**) - JG Ch. 21
- Issue with Income Taxation: Taxing Savings; Theory, Evidence; Incentive mechanisms; Application to retirement savings, entrepreneurial activities, innovation (**Lecture 13**) - JG Ch. 22
- Impact of Wealth Taxes on Risk-Taking Behavior (**Lecture 14**) - JG Ch. 23
- Corporate Taxation (**Lecture 15**) - JG Ch. 24
- Fundamental Tax Reform (**Lecture 16**) - JG Ch. 25
- Project Presentation (**Lecture 17**)

• Project Presentation (**Lecture 18**)

References

Auerbach, Alan J. "Taxation and corporate financial policy," Chapter 19 in the *Handbook*, Vol. 3.

Auerbach, A., and K. Hassett. "On the Marginal Source of Investment Funds." *Journal of Public Economics* 87, no. 1 (2003): 205–32.

Bernheim, Douglas B. "Taxation and saving," Chapter 18 in the *Handbook*, Vol. 3.

Bricker, J., A. Kennickell, et al. "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances." (PDF) *Federal Reserve Bulletin* 98, no. 2 (2012): 1–80.

* Chetty, R., A. Looney, et al. "Salience and Taxation: Theory and Evidence." *American Economic Review* 99, no. 4 (2009): 1145–77.

Chetty, R. "Bounds on Elasticities with Optimization Frictions: A Synthesis of Micro and Macro Evidence on Labor Supply." *Econometrica* 80, no. 3 (2012): 969–1018.

Chetty, R., J. Friedman, et al. "Adjustment Costs, Firm Responses, and Micro vs. Macro Labor Supply Elasticities: Evidence from Danish Tax Records." *Quarterly Journal of Economics* 126 (2011): 749–804.

* Diamond, Peter, "A many-person Ramsey tax rule," *Journal of Public Economics*, 1975

* Peter Diamond and James A. Mirrlees, "Optimal taxation and public production, I and II", *American Economic Review*, LXI8-27 and 261-278

Eissa, Nada et al. "Evaluation of four tax reforms in the United States: Labor supply and welfare effects for single mothers," *Journal of Public Economics*, 2008, 795-816.

Fama, E., and K. French. "Financing Decisions: Who Issues Stock?" *Journal of Financial Economics* 76 (2005): 549–82.

Givoly, D., et al. "Taxes & Capital Structure: Evidence from Firms' Responses to the Tax Reform Act of 1986." *Review of Financial Studies* 5 (1992): 331–55.

Graham, J. "A Review of Taxes and Corporate Finance." *Foundations and Trends in Finance* 1, no. 7 (2006): 573–691.

* Gruber, J., and B. Koszegi. "Tax Incidence When Individuals Are Time-Inconsistent: The Case Of Cigarette Excise Taxes." *Journal of Public Economics* 88, no. 9–10 (2004): 1959–87.

Hassett, Kevin and R. Glenn Hubbard, "Tax policy and business investment," Chapter 20 in the *Handbook*, Vol. 3.

Huang J.T., "The personal tax exemptions and married women's birth spacing in the U.S.," *Public Finance Review*, November 2008, 728-47.

Imbens, G., D. Rubin, et al. "Estimating the Effect of Unearned Income on Labor Earnings, Savings, and Consumption: Evidence from a Survey of Lottery Winners." *American Economic Review* 91, no. 4 (2001): 778–94.

Keane, M. "Labor Supply and Taxes: A Survey." *Journal of Economic Literature* 49, no. 4 (2011): 961–1075.

Knittel, M. "Corporate Response to Accelerated Tax Depreciation: Bonus Depreciation for Tax Years 2002-2004." (PDF) U.S. Treasury Office of Tax Analysis Working Paper 98, May 2007.

Korinek, A., and J. Stiglitz. "Dividend Taxation and Intertemporal Arbitrage." *Journal of Public Economics* 93, no. 1–2 (2009): 142–59.

Kumar, A. "Labor Supply, Deadweight Loss, and the Tax Reform Act of 1986: A Nonparametric Evaluation Using Panel Data." *Journal of Public Economics* 92, no. 1–2 (2008): 236–53.

* Mirrlees, James A. "An exploration in the theory of optimum income taxation," *Review of Economic Studies*, 1971, 175-208.

Poterba, J. "Taxation and Corporate Payout Policy." *American Economic Review* 94, no. 2 (2004): 171–5.

* Sandmo, Agnar, "Optimal taxation in the presence of externalities," *The Swedish Journal of Economics*, 1975

* Stiglitz, Joseph E. "Effects of wealth, income and capital gains taxation on risk taking," *Quarterly Journal of Economics*, 1969, 263-83.